

Financial Transactions and Fraud Schemes:

*Asset Misappropriation:
Inventory and Other Assets*

Misuse of Inventory and Other Assets

- There are basically two ways a person can misappropriate a company asset. The asset can be *misused* or it can be *stolen*.
- The most common example of misuse of assets is using company equipment to do personal work on company time.

Theft of Inventory and Other Assets

- Larceny Schemes
 - False Sale
 - Employee pretends to ring up sale
 - Accomplice takes inventory without paying for it
 - Sale not recorded



Theft of Inventory and Other Assets

- Purchasing and Receiving Schemes
 - Employee intentionally purchases inventory with the intent to misappropriate once received
 - Falsifying incoming shipments
 - Amount received is modified to reflect lesser amount to conceal theft
 - May need to modify receiving report to conceal loss

Theft of Inventory and Other Assets

- Concealing Inventory Shrinkage
 - The unaccounted-for reduction in inventory resulting from error or theft
 - Altered inventory records
 - Fictitious sales
 - Write-off as scrap
 - Physical padding



Detection and Prevention

- Analytical review
 - Cost of goods sold increases by a disproportionate amount relative to sales
- Proper documentation
 - Prenumber and control receiving reports
- Separation of duties (receipt, disbursement, conversion to scrap)
- Independent checks (not purchasing or warehouse staff)
- Physical safeguards

Sample Prep Question

1. Which of the following is NOT a method that is used to conceal inventory shrinkage?
 - A. Physical padding
 - B. Forced reconciliation of the inventory records
 - C. Selling merchandise without recording the sale
 - D. Writing off stolen inventory as scrap

Correct Answer: C

- Selling merchandise without recording the sale is not a method used to conceal shrinkage.
- Some fraudsters try to make it appear that there are more assets present in the warehouse or stockroom than there actually are by physically padding the inventory. In one case, employees stole liquor from their stockroom and restacked the containers for the missing merchandise. This made it appear that the missing inventory was present when in fact there were really empty boxes on the stockroom shelves.

Sample Prep Question

2. Which of the following is a method that would help prevent the theft of company inventory?
- A. Using prenumbered shipping documents, perpetual inventory records, and inventory receiving reports
 - B. Restricting inventory access to authorized personnel
 - C. Separating the duties of handling incoming shipments and filling out the inventory requisition form
 - D. All of the above

Correct Answer: D

- There are four basic measures which, if properly installed and implemented, might help prevent inventory fraud. They are proper documentation, separation of duties (including approvals), independent checks, and physical safeguards.
- The following duties should be handled by different personnel:
 - Requisition of inventory
 - Receipt of inventory
 - Disbursement of inventory
 - Conversion of inventory to scrap
 - Receipt of proceeds from disposal of scrap

Sample Prep Question

3. An analytical review reveals that Rollins Company's cost of goods sold increased by 80 percent last year. Its sales, however, only increased by 40 percent. What might this discrepancy indicate?
- A. Sales were unusually poor this year versus last year.
 - B. Inventory has been depleted by theft.
 - C. The quantity of items purchased decreased.
 - D. There were more sales returns this year than in the prior year.

Correct Answer: B

- Inventory fraud might be detected by using an analytical review because certain trends become immediately clear. For example, sales and cost of goods sold should move together since they are directly related. However, if the cost of goods sold increases by a disproportionate amount relative to sales, and no changes occur in the purchase prices, quantities purchased, or quality of products purchased, the cause of the disproportionate increase in cost of goods sold might be one of two things: (1) ending inventory has been depleted by theft or (2) someone has been embezzling money through a false billing scheme.

Financial Transactions and Fraud Schemes

Financial Institution Fraud

Financial Institution Fraud

- Financial institutions include banks, savings and loans, credit unions, and other governmentally insured repositories.
- Bank—organization engaged in financial functions, including:
 - Receiving, collecting, transferring, paying, lending, investing, dealing, exchanging, and servicing money and claims to money

Embezzlement Schemes

- False Accounting Entries
- Unauthorized Withdrawals
- Unauthorized Disbursement of Funds to Outsiders
- Moving Money from Customers' Dormant or Inactive Accounts
- Theft and Other Unauthorized Use of Collateral

Embezzlement Schemes

- Red flags:
 - Missing source documents
 - Unusual amount of out-of-sequence check numbers
 - Payees on source documents (e.g., checks) do not match entries in the general ledger
 - Receipts or invoices lack professional quality
 - Duplicate payment documents
 - Payee identification information that matches an employee's or his relatives
 - Apparent signs of alteration to source documents
 - Lack of original source documents (photocopies only)

Loan Fraud

- Highest risk area for financial institutions
- Smaller number of occurrences, but dollar amount is usually larger



Loan Fraud Schemes

- Loans to Nonexistent Borrowers
- Sham Loans with Kickbacks and Diversion
- Double-Pledging Collateral
- Swapping Bad Loans
 - Daisy Chains—a bank buys, sells, and swaps its bad loans for those of another bank, creating new documentation in the process



Construction Loan Fraud Areas

- Estimates of costs to complete
 - Change orders
- Developer overhead
 - Supplying developer with operating capital during project
- Draw requests
 - Documentation for incurred expenses, requests reimbursement
- Retainage
 - Amount withheld until construction is complete and the lien period expires

Red Flags of Loan Fraud

- Nonperforming Loans
 - Close to default
- Change Order Abuse
- Missing Documentation

CHANGE ORDER

BORROWER'S INFORMATION

LOAN INFORMATION

NAME	ADDRESS	PHONE NUMBER
CITY/STATE/ZIP	LOAN NUMBER	ACCOUNT NUMBER
DATE	DATE	

CHANGES TO FOLLOWED BY THE ORIGINAL CONTRACT

Mortgage Fraud

- Air loans
 - Loan for a nonexistent property
- Fraudulent sale
 - Fraudulent second lien
- Property flipping
 - Buying and selling real estate quickly
- Property flopping
 - Variation of flipping but involves a property subject to a short sale

New Account Fraud Schemes

- Fraud is more likely to occur in new rather than existing or established accounts
- Detection
 - Residence outside the bank's trade area
 - Dress and/or actions inconsistent or inappropriate for the customer's stated age, occupation, or income level
 - New account requesting immediate cash withdrawal upon deposit
 - Request for large quantity of temporary checks

Sample Prep Question

1. Which of the following usually represents the highest loss amount for fraud in financial institutions?
 - A. Embezzlement
 - B. Teller fraud
 - C. Loan fraud
 - D. False statements

Correct Answer: C

- Loan fraud is a multifaceted activity that includes several types of criminal activities. Larger loan fraud schemes often involve real estate lending and collusion between insiders and outsiders. Loan fraud represents the highest risk area for financial institutions. Although the number of occurrences may be small, the dollar amount per occurrence tends to be large.

Sample Prep Question

2. A draw request on a construction loan should be accompanied by all of the following EXCEPT:
- A. Lien releases from subcontractors
 - B. Inspection reports
 - C. Change orders, if applicable
 - D. Expenses from similar contracts

Correct Answer: D

- A draw request is the documentation substantiating that a developer has incurred the appropriate construction expenses and is now seeking reimbursement or direct payment. The request should be accompanied by the appropriate documents.

Sample Prep Question

3. Karl finds a residential property with a non-resident owner. He then forges contractual property documents showing that the owner is transferring ownership of the property completely to Karl, such as would normally happen during a property sale. The property owner is unaware that Karl has created and filed the documents. Later, Karl takes the falsified documents to a lender and borrows money against the property. Which of the following best describes Karl's scheme?
- A. Property flipping
 - B. Unauthorized draw on home equity line of credit
 - C. Air loan
 - D. Fraudulent sale

Correct Answer: D

- In a *fraudulent sale* scam, the perpetrator identifies a property—typically belonging to an estate or non-resident owner—that is owned free and clear. He then creates fictitious property transfer documents that purport to grant all rights and title on the property to the fraudster. The true owner's signature is forged on the documents, and the scammer files them in the jurisdiction's real property records. Once the ownership documents are filed, he applies for and executes a loan on the property (using a straw borrower). Often, the value is inflated. He pockets 100 percent of the loan proceeds and disappears.

Financial Transactions and Fraud Schemes

Health Care Fraud

Fraud by Insurance Companies

- Submission of false documents
- Mishandling claims
- Failure to pay legitimate claims
- Charging unapproved rates
- Requesting rate increases based on fraudulent data
- Deceptive or illegal sales practices
- Failure to give “fee breaks”
- Patient screening

Provider Fraud

- Practices by health care providers (practitioners, medical suppliers, and medical institutions) that cause unnecessary costs to health care programs or patients through reimbursement for unnecessary or excessive services
- Fictitious provider
- Phantom services
- Rolling labs
- Equipment and supplies schemes
 - Reusable medical equipment suppliers

Red Flags of Provider Fraud

- Pressure for rapid adjudication of bills or claims
- Threats of legal action
- Frequent telephone inquiries
- Demand same-day claim payment
- No supporting documentation
- Patient's address is the same as the provider's
- Routine (not specialized) treatment for patients living several hours away
- Referring physician and provider of service in same office
- Medical records that have been altered
- Medical records that have additional information attached that would make an apparent noncovered service now covered
- Missing pages of medical records that would cover the period of time under review

Kickbacks

- Payment for referral of patients
- Waiver of deductibles and copayments
- Payment for additional medical coverage
- Payment for vendor contracts
- Payment to adjusters



Inflated Billings

- Altered Claims
 - Amounts, dates, names
- Added Services
 - Onto legitimate billing
- Code Manipulation
 - Medical coding is a process of assigning codes to determine costs and facilitate payments to providers
 - Fraud occurs when the provider enters an incorrect diagnostic or procedural code to obtain some benefit
- Unbundling Charges and Fragmentation
 - Provider charges a comprehensive code as well as one or more component codes

Inflated Billings, con't.

- Mutually Exclusive Procedures
 - Services that should not be performed together
- Global Service Period Violations
 - E.g., tacking on fees related to surgery near its date
- Upcoding
 - Billing for a higher level of service than was rendered
 - E.g., filling generic Rx while billing for market-brand Rx

Insured and Beneficiary Fraud

- Fictitious claims
 - Beneficiaries or insureds might submit fictitious claims forms for:
 - Multiple surgeries
 - Multiple office visits
 - Foreign claims
 - Noncovered dependents

HEALTH INSURANCE CLAIM FORM (F)

1a. INSURED'S I.D. NUMBER

4. INSURED'S NAME (Last Name, First Name)

ADDRESS (No., Street)

FECA BLK LUNG (SSN) OTHER (ID)

DATE SEX M F

RELATIONSHIP TO INSURED

Child

CITY TEL

Potential Indicators of Fraud by an Insured Party

- Pressure by a claimant to pay a claim quickly
- Individuals who hand-deliver their claims and insist on picking up their payment in-person
- Threats of legal action if a claim is not paid quickly
- Anonymous telephone call or email inquiries regarding the status of a pending claim

Fraud by Medical Institutions

- DRG (diagnostic-related groupings) creep
 - Misclassifying patient and procedure for higher reimbursement
- Billing for experimental procedures
- Revenue recovery firms
 - Add extra charges to increase fee
 - Kickbacks
- Rent-a-Patient Schemes
 - Pay people to undergo unnecessary treatments

Fraud in Special Care Facilities

- Unscrupulous providers can operate their schemes in volume because the patients are all under one roof.
- Patients lack mental capacity.
- Special care facilities might make patient records available to outside providers who are not responsible for the direct care of the patient (in violation of regulations).
- Questionable claims are not timely flagged by automated systems.
- Even when abusive practices are detected and prosecuted, repayment is rarely received from wrongdoers because they usually go out of business or deplete their resources so that they lack any resources to repay the funds.

Sample Prep Question

1. Adams is admitted to Pinevalley Hospital to have a pacemaker installed. When the hospital bills the insurance company for the procedure, it bills for a triple bypass heart surgery instead. This type of fraud is referred to as which of the following?
 - A. Profiling
 - B. DRG creep
 - C. Overutilization
 - D. Pharming

Correct Answer: B

- Diagnostic-related groupings (DRG) is a reimbursement methodology for the payment of institutional services. DRG categorizes patients who are medically related with respect to primary and secondary diagnosis, age, and complications. Reimbursements are determined by the allowance for the DRG. For example, a heart bypass operation is worth a certain amount of reimbursement and a hernia repair is worth a different amount. *DRG creep* occurs when a hospitalization is coded as a more complex admission than actually occurred.

Sample Prep Question

2. A health care provider's practice of charging a comprehensive code, as well as one or more component codes, by billing separately for subcomponents of a single procedure is known as _____.
- A. Capping
 - B. Unbundling
 - C. Upcoding
 - D. None of the above

Correct Answer: B

- Coding fragmentation involves the separation of one medical procedure into separate components to increase charges. Instead of charging for a hysterectomy under one code, the provider would charge for a laparotomy (cutting the abdomen), as well as for the removal of the individual organ. This is often referred to as *unbundling*.

Sample Prep Question

3. Examples of fraud schemes perpetrated by health care institutions and their employees include all of the following EXCEPT:
- A. Billing for experimental procedures
 - B. DRG creep
 - C. Unintentional misrepresentation of the diagnosis
 - D. Improper additions by revenue recovery firms

Correct Answer: C

- Fraud schemes perpetrated by institutions and their employees include those commonly used by doctors and other providers. However, the more common schemes in which institutions are primarily involved include: filing of false cost reports, DRG creep, billing for experimental procedures, improper contractual and other improper relationships with physicians, and revenue recovery firms to bill extra charges.

Financial Transactions and Fraud Schemes

Insurance Fraud

Insurance Fraud

- The insurance business, by its very nature, is susceptible to fraud.
 - Property Insurance
 - Casualty Insurance
 - Health Insurance
 - Disability Insurance
 - Life Insurance
 - Fidelity Insurance
 - Bonds and Indemnification

Agent/Broker Fraud

- Cash, Loan, and Dividend Checks
- Settlement Checks
 - Orphan contract holder—
 - Policyholder who has not been assigned an agent or whose whereabouts are unknown
- Agent Fraud (Premium Theft)
- Fictitious Payees
- Fictitious Death Claims

Underwriting Irregularities

- Misrepresentation
- False Information
- Fictitious Policies
 - *Tombstone* policies
- Surety and Performance Bond Schemes
- Sliding
 - Including additional coverages in an insurance policy without the insured's knowledge



Vehicle Insurance Schemes

- Ditching
 - AKA “Owner give-ups”
 - Getting rid of a vehicle to collect on an insurance policy
- Past Posting
 - Uninsured driver has accident, gets policy, then reports that claim



Red Flags of Insurance Fraud

- Claim made short time after the policy's inception, or after an increase or change in the coverage
- History of many claims and losses
- Hypothetical questions about coverage in the event of a loss similar to the actual claim
- Very pushy and assertive about a fast settlement, and exhibits more than the usual amount of knowledge about insurance coverage and claims procedures

Red Flags of Insurance Fraud

- In a burglary loss, claim includes large, bulky property
- In a theft or fire loss claim, the claim includes a lot of recently purchased, expensive property, or the insured insists that everything was the best or the most expensive model
- In a fire loss claim, personal property you would expect to see—photographs, family heirlooms, or pets—is absent

Workers' Compensation Fraud

- Requires employers or their insurance plan to reimburse an employee for injuries that occurred on the job regardless of fault

Common W.C. Schemes

- Premium Fraud
 - Misrepresenting company information to lower WC premiums
- Agent Fraud
 - Agent issues certificate to insured showing coverage, but never remits premium
- Claimant Fraud
 - Worker misrepresents information relating to “injury”
- Organized Fraud
 - Collusion among lawyer, capper, doctor, and/or claimant, or combination thereof

Sample Prep Question

1. In the insurance industry, a policyholder or contract holder whose whereabouts are unknown is referred to as a(n):
 - A. Capper
 - B. Orphan
 - C. Runner
 - D. None of the above

Correct Answer: B

- An orphan contract holder is a policyholder or contract holder who has not been assigned to a servicing agent or whose whereabouts are unknown.

Sample Prep Question

2. One type of vehicle insurance scam involves the owner of a vehicle abandoning it and falsely reporting it as stolen. This type of scam is called:
- A. Ditching
 - B. Churning
 - C. Past posting
 - D. Capping

Correct Answer: A

- Ditching, also known as owner give-ups, involves getting rid of a vehicle to collect on an insurance policy or to settle an outstanding loan.

Sample Prep Question

3. When an insurance salesperson writes a “tombstone” policy, he has committed which of the following?
- A. Sliding
 - B. Writing a fictitious policy
 - C. Twisting
 - D. All of the above

Correct Answer: B

- An insurance salesperson might submit fictitious policies called “tombstone policies” to improve his sales record or increase his commissions. The term *tombstone policy* came into being because agents would literally copy names from tombstones to write the new, fictitious policies.